

Good MornING Asia - 28 September 2018

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By Robert Carnell



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No help for Asian FX from the EUR

Our house view on EUR/USD from our FX team has been bullish all year, and if memory serves me right, from 2017 too, with a 1.30 end-2019 forecast. As a directional call, there is much to be said for it, though even they would probably concede that the magnitude can be a tough sell at times.

Scope for a break out in the direction of our house call was looking promising at the end of last week and would have taken some of the pressure off our Asian FX pairs, which have been battered since 2Q18 on a mixture of dollar strength and EM weakness. Both these pressures were showing signs of abating recently, allowing perhaps for some retracement.

But for the USD to really weaken, part of the story had to include a stronger EUR. That part has been dealt a blow by the Italian government budget proposal of a 2.4% deficit. 2.4% may not sound like much, and it is within the Maastricht deficit limit of 3.0%. But against a backdrop of public debt that exceeds 130% of GDP and a real growth rate that has exceeded 2.4% only very briefly and fleetingly since 2000, 2.4% appears unsustainable and could set the Italian government up for a row with the EU commission. For much more on this and the somewhat disappointing recent growth performance of the Eurozone, our Eurozone team's [latest quarterly](#) should answer all your questions, and more.

It's EUR weakness, not USD strength

The Italian budget decision has weighed heavily on the EUR, which from about 1.18 earlier in the week, has pushed down through its 100-day moving average and is now somewhere around 1.1635. This really is a surprisingly strong turnaround in fortunes and indicates how weak the recent EUR up-move may have been.

Fortunately, so far this hasn't filtered through into any Asian FX weakness, so we can perhaps view this move primarily as EUR weakness, not dollar strength. This is a far less negative story for the Asian region. Though we may also want to factor in the helpful actions by BI (Bank Indonesia) and BSP (Philippine Central Bank) central banks yesterday, both of which lived up to expectations in hiking policy rates. Next Friday sees the RBI (Reserve Bank of India) probably following suit...

Oil really not helping the more challenged parts of Asia

We were hoping that the resurfacing of commentary on the EU, Russia and China's special purpose vehicle (SPV) for resuming oil trade with Iran, might take the pressure off crude oil prices. The absence of Iran from global oil supply seems to be the single biggest factor pushing prices higher than our commodity analysts have been expecting, though logistical bottlenecks from US shale output will also not have helped.

As well as pushing inflation higher in economies such as the Philippines, higher crude oil is also providing an unhelpful negative push to regional trade balances, Indonesia and India for example. Coupled with a softer dollar (as mentioned - still largely elusive) lower crude prices could quickly change the Asian backdrop to a far more positive one - which would be very welcome given the fact that the negative impacts of the US-China trade war are becoming somewhat clearer in the data, and could spill over into other countries in the region.

So far though, that is all that this appears to be, and it is not obvious that this SPV will deliver a practical alternative for countries wanting to circumvent US trade restrictions. Were this to change, so too could crude benchmarks, which might come much closer to our end of year \$75/bbl forecast (Brent).

Asia Day ahead

A slew of Japanese data has already filled the data screens, with perhaps the most eye-catching, being the above expectations Tokyo September CPI figures - these now showing inflation in the capital at 1.3% (up from 1.2%). Where Tokyo CPI goes, the national figures almost always follow, and in any case, a combination of energy price rises, and weather-induced food price spikes was likely to push national inflation rates further above 1.0% (currently 1.3%), providing more cover for the BoJ to conduct its stealth tapering.

In this vein, there is quite a lot of talk about cuts to the BoJ's regular super-long asset purchases, and maybe a reduction in the number of their monthly operations too. If so, this could result in some JPY strength - JPY currently looking quite soft at 113.38.

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International theme: Keep watching the data in the US

- Powell reiterated that the Fed would remain data dependent as it continues to gauge the appropriateness of monetary policy, telling markets to weigh economic data releases more than statements from FOMC officials. Economic data showed core capital goods fell into contraction as did pending home sales.
- On the trade front, the US continues to be at odds with China and Canada, with prime minister Trudeau refusing to budge at the negotiating table while China denied allegations of favoring the Democratic party at the US mid-term election.

EM Space: Dots a wrap; Asia continues to digest Fed tone and look to trade for direction

- **General Asia:** Traders will continue to digest the Fed's tone and the dot plots while looking to fresh developments on rising oil and trade negotiations between the US with Canada and China.
- **Thailand:** August balance of payments data is due. We estimate the current account surplus to be little changed from the July level of \$1.1bn. We infer from reduced foreign

reserves outflow that the overall payments balance improved in August, as the local markets bucked the EM sell-off with \$1.8bn of net inflow in the bond market and 1.7% THB appreciation. We expect the THB to remain as Asia's outperforming currency this year, and probably beyond.

- **Indonesia:** The Bank of Indonesia raised rates as expected by 25 bps to 5.75% as the central bank looks to remain ahead of the curve. The central bank also indicated it was busy readying non-interest rate measures to stem IDR volatility and should these alternative measures take hold, we may see BI keeping the powder dry and hold off on rates for the rest of the year.
- **Philippines:** The Philippines hiked policy rates by 50 bps as expected to 4.5% in a bid to anchor inflation expectations and limit FX volatility. Second round effects have begun to take root with the central bank looking to anchor expectations. Inflation forecasts now point to a breach in the 2019 target, bringing us to forecast a possible 25 bp rate hike by year-end.

What to look out for: Manufacturing data in coming week

- US-Canada trade negotiations (deadline: end of September)
- Argentina-IMF credit line request (on-going)
- Manufacturing data out from China (30 September)
- Manufacturing data out from EZ (1 October)
- Central bank meeting India (5 October)

Article | 28 September 2018

Asia week ahead: Calm after the storm

After a hectic week, the Golden Week holiday in China should bring some calm to markets. The key question for next week is whether the Indian central bank...



Source: Shutterstock

➔ A holiday-shortened week

Asian market liquidity is expected to be thin, as Chinese markets are closed for a holiday during 1-7 October, and Hong Kong, Korea, and India are also out on public holiday on other days of the week. Nevertheless, it's quite a busy economic calendar dominated by manufacturing, trade, and inflation releases and the central bank meeting in India.

The weekend release of China's purchasing managers index, followed by PMI releases for other Asian economies on Monday will set the tone for the markets. The key focal point in PMIs will be the new export order components and we'll be keeping an eye out for what that says about the trade war impact. However, this is still a soft indicator.

➔ What's happening to Asian exports?

The hard data on Korea's export performance in September will be hitting the newswires early on Monday morning, and that will be worth watching as a leading indicator for the rest of Asian exports.

The base effect is kicking in. Korean export growth peaked at 35% year-on-year in September 2017. But apart from the high base effect, our estimate of over 5% YoY export decline this September reflects a slack towards the end of the month due to the mid-Autumn festival holiday. But a 22% YoY surge in exports in the first 20 days of the month, partly on the back of front-loading of shipment is still a strong performance, that reinforces no big hit to regional exports from the trade war yet.

The recent signing of the US-Korea Free Trade Agreement bodes well for the export outlook.

➔ Inflation not an issue in Asia, barring Philippines

Of several September inflation releases, Philippines' data will be the highlight. The supply disruptions due to the worst typhoon in recent years will have undoubtedly bumped up inflation higher from August's 6.4% rate. Our forecast for September is 6.9%, and we feel it is now close to peaking.

The Philippines central bank (BSP) raised the policy rate by another 50bp to 4.50% this week, taking the cumulative hike since May to 150bp. However, this still leaves a negative real interest rate as a pull on the currency. We don't think the BSP tightening cycle is over just yet and the Bank is likely to remain vigilant of the impact of a weak peso on inflation in the future. We expect one more 25bp rate hike before the end of the year.

Indonesia, Taiwan, and Thailand are other countries to report September inflation, but we expect nothing exciting here.

➔ Will India's Reserve Bank hike by more than 25bp?

The Reserve Bank of India unveils its monetary policy decision next Friday (5 October).

Speculation is rife about the RBI joining ranks with its Indonesian and Philippines counterparts in aggressive tightening to curb currency weakness, but we're far from convinced. Although the RBI needs more tightening, it's likely to argue that inflation, the main policy target, has been well-behaved, currently under the 4% (+/-2%) medium-term target.

We continue to forecast one more 25bp RBI rate hike this year at the December meeting, and two hikes in 2019

Not only inflation, but ongoing troubles in India's financial sector from a serial default by a non-bank finance company on its debt obligations and resultant liquidity squeeze are other limitations on the RBI in going for more than the conventional 25bp hike. Also, the government has started taking measures to rein in the rupee's weakness - which although have so far proved to be

inadequate, reduce the onus on the RBI to support the currency.

We still can't underestimate the potential inflationary impact of ongoing currency depreciation, which will further be complicated by the impact of higher oil prices due to the supply disruption from Iran sanctions. If not in the next couple of months, we expect inflation to rear its head again, thus keeping the RBI busy going forward.

We continue to forecast one more 25bp RBI rate hike this year in the December meeting, and two hikes in 2019.

Asia Economic Calendar

Country	Time	Data/event	ING	Survey	Prev.
Sunday 30 September					
China	0200	Sep Non-manufacturing PMI	-	54	54.2
	0200	Sep Manufacturing PMI	-	51.1	51.3
Monday 1 October					
India	0600	Sep Nikkei Manufacturing PMI	-	-	51.7
Indonesia	0400	Sep CPI (MoM/YoY%)	0.4/3.1	-	-0.1/3.2
Korea	0000	Sep Exports (YoY%)	-5.5	-	8.7
	0000	Sep Imports (YoY%)	7.8	-	9.2
	0000	Sep Trade balance (US\$m)	7114	-	6853
	0000	Sep Nikkei manufacturing PMI	48.9	-	49.9
	2100	Oct BOK Business Survey Index, mfg	77	-	77
	2100	Oct BOK Business Survey Index, non-mfg	78	-	77
	2300	Aug Industrial Production (MoM, SA/YoY%)	0.5/1.6	-	0.4/0.9
Malaysia	0030	Sep Nikkei Manufacturing PMI	50.5	-	51.2
Philippines	0030	Sep Nikkei Manufacturing PMI	-	-	51.9
Taiwan	0200	Sep Nikkei Manufacturing PMI	52.9	-	53
Thailand	0030	Sep Nikkei Manufacturing PMI	-	-	49.9
	0430	Sep CPI (YoY%)	1.1	-	1.6
	0430	Sep CPI Core (YoY%)	0.8	-	0.8
Tuesday 2 October					
Hong Kong	0815	Aug Retail Sales Value (YoY%)	8.6	-	7.8
	0815	Aug Retail Sales Volume (YoY%)	6.2	-	5.9
Singapore	1330	Sep Purchasing Managers Index	52.4	-	52.6
Thursday 4 October					
India	0600	Sep Nikkei Services PMI	-	-	51.5
Hong Kong	0230	Sep Nikkei PMI	-	-	48.5
Indonesia	1000	Sep BI Consumer Confidence Index	-	-	121.6
Thailand	0330	Sep UTCC's Consumer Confidence	-	-	83.2
Friday 5 October					
India	1000	RBI Policy Decision (Repo Rate, %)	-	-	6.5
Malaysia	0400	Aug Exports (YoY%)	4.5	-	9.4
	0400	Aug Imports (YoY%)	5.5	-	10.3
	0400	Aug Trade balance (RM bn)	9.6	-	8.3
	0900	Sep Forex Reserves- Month end (US\$bn)	-	-	103.9
Philippines	0100	Sep CPI (YoY%)	6.9	-	6.4
	0900	Sep Forex Reserves (US\$bn)	-	-	77.9
Taiwan	0030	Sep CPI (YoY%)	1.7	-	1.5
	0030	Sep WPI (YoY%)	6.5	-	6.8
	0820	Sep Forex Reserves (US\$bn)	461.5	-	459.9

Source: ING, Bloomberg

Trade war eating up China industrial profits

While other data still have yet to show the trade war impact, industrial profits seem to show that the trade war is eating up profits of manufacturers in...



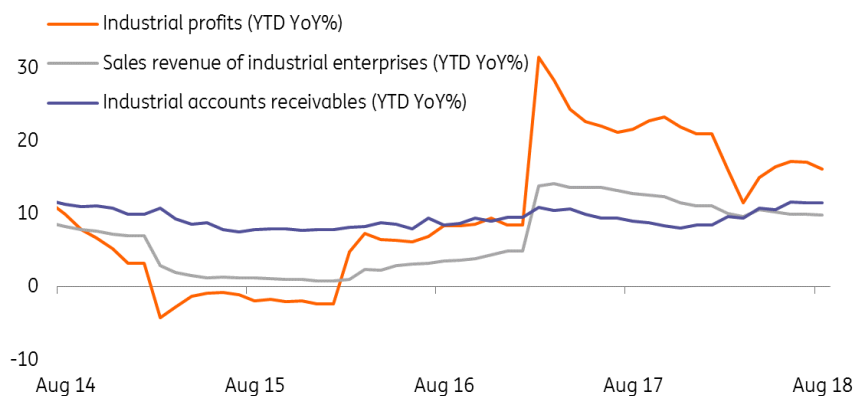
Source: Shutterstock

Trade war impact has started

Industrial profits of manufacturers in China slowed to 9.2% YoY in August from 16.2% YoY in July. These manufacturers include foreign investments in China.

Not only have profits slowed but account receivables have increased. The data pair reflects that manufacturers could, in fact, be earning much lower profit margins than reported if the account receivables cannot be collected in the future.

At the same time, sales growth has also fallen.



Source: ING, Bloomberg

Trade war has hit foreign-owned factories in China

Foreign-owned factories have faced slower profit growth (+7.6% YoY) than Chinese-owned private enterprises (+10.0% YoY), and of course more so compared to state-owned enterprises (SOEs) at 26.7% YoY. We believe that the higher profit growth of SOEs come from some projects that could be related to fiscal stimulus, eg, railway infrastructure projects. And those no so profitable infrastructure projects, eg, anti-pollution, could be under local government financial vehicles, which are not considered as local government entities but corporate entities.

Are these the result of the trade war? Yes!

We would like to explore alternative factors affecting industrial profits in China, but it is difficult to find an excuse not to blame the trade war.

Overcapacity reform has stopped since the start of the trade war in the middle of the year. In fact, financial deleveraging has become re-leveraging as interest cost has lowered quickly.

We, therefore, conclude that this slowdown in industrial profits is a result of the trade war.

Interest cost has fallen



Source: ING, Bloomberg

Indonesia: BI walks the talk, hikes rates by 25bps

Bank Indonesia (BI) followed through on its pledge for pre-emptive steps by carrying out a 25 basis point rate hike. The bank's decisive stance has...



5.75%

BI 7-day reverse repurchase rate

25bps hike

As expected

Governor Warjiyo looks to remain ahead of the curve

Following through on his 5 September pledge to take “pre-emptive” steps to stay ahead of the curve as Indonesia faces new developments, the Bank of Indonesia nudged its 7-day reverse repurchase rate by 25 basis points higher to 5.75%. The move was widely expected and predicted by 27 out of 37 economists in the latest Bloomberg survey.

BI has increased its policy rate a total of 150 basis points for the year with Governor Perry Warjiyo looking to stabilise the Indonesian Rupiah (IDR) and keep local bond yields attractive to draw in foreign funds. In addition to rate hikes, Indonesia looks to roll out non-monetary measures to curb

IDR weakness, expanding its policy toolkit to include measures such as limiting luxury goods imports, hedging instruments for corporates, and enticing exporters to convert half of their earnings to IDR.

IDR stabilises after decisive BI

The Indonesian rupiah has depreciated by roughly 9.9% year-to-date as Indonesia's current account deficit to GDP deteriorated to -2.36% in 2H 2018 from -1.71% at the end of 2017. In the wake of the emerging market contagion at the start of September, the IDR slumped to 14935, the weakest level since the Asian financial crisis, prompting Governor Warjiyo to signal immediate countermeasures to stem the tide. Since then, the IDR has stabilised with the government deploying further measures to stem the foreign currency outflows.

Hawkish now, hawkish again tomorrow

With BI officials telegraphing that monetary authorities will maintain their current stance until next year, we can expect BI to remain busy deploying a host of measures to address IDR volatility. Central bank rate hikes moving in tandem with its planned hedging programmes and tax incentives for exporters will likely contribute to IDR stability in the near term, especially as Governor Warjiyo appears to enjoy a degree of credibility from the market.

Philippines central bank whips out another 50 bps rate hike

The central bank raised its policy rate by 50 basis points to 4.5% as it looks to anchor inflation expectations



4.5%

Overnight reverse repurchase rate

50 bps hike

As expected

Central bank hikes to counter second round effects

With inflation well above the central bank's 2-4% target and clear signs of second round effects

evident, the Bangko Sentral ng Pilipinas (BSP) looked to wield yet another 50 basis point rate hike to sniff out brewing concerns about price pressures.

The BSP hiked its policy rate to 4.5%, a move widely expected by the 20 out of 22 analysts surveyed by Bloomberg, as it continues to chase its inflation target for 2019. Price pressures persistently come from the supply side. However, the central bank has now vowed to reduce volatility in the exchange rate to help anchor inflation expectations. Furthermore, so-called second round effects in the form of wage increases and transport fare adjustment have been implemented.

Another round of rate hikes?

Although inflation is expected to slow down in the fourth quarter, the BSP may still be called to enact another round of rate hikes as inflation expectations remain elevated going into 2019.

Hawkish comments from Deputy Governor Diwa Guinigundo were welcome as the BSP looked to demonstrate the central bank's commitment to achieving its target. Thus, it will be imperative for non-monetary policy measures to help alleviate price pressures as we approach the all-important Christmas season, a crucial turning point ahead of the mid-term elections in May.

Barring any additional calamities, both natural and man-made, we expect inflation to revert within target towards the latter half of 2019. BSP's forecast for 2019 inflation has been pegged at 4.3%, and we expect inflation to fall within target by end-2019.

Taiwan central bank on hold while we cut our GDP forecast

We expect the central bank to stay put for 2018 and perhaps even for 2019 as it is difficult to cut interest rates to help a gradually slowing economy....



Source: Shutterstock

Economy is not good but not bad either for a rate cut, but it deserves a GDP downgrade

As the economy is too reliant on the manufacturing sector, and the trade war between Mainland China and the US could hurt the supply chain of the semi-conductor industry, Taiwan may be hurt by this trade war indirectly.

This makes us revise our GDP forecasts downward for 3Q18 from 2.4% YoY to 2.0% YoY, from 2.5% to 2.4% for 2018, and from 2.4% to 2.0% in 2019.

We had thought that Taiwan might be able to gain from this trade war as a substitute manufacturer, but it seems that either this takes a long time or Taiwan's products are in fact part of China's products, which is very likely. Therefore Taiwan is hardly benefiting from the substitution effect of China's slower production of electronics due to this trade war.

So the Taiwan economy is not growing as fast as we have thought.

But it is not as bad as in a recession either. The central bank can only stay put for now and save the rate cut as a last resort.

2.0% YoY GDP forecast for 3Q18 from 2.4% YoY

Manufacturing growing too slowly

Industrial production fell sharply to a low growth level in August from a decent growth level in July. Though there is a high base effect the growth is just too slow. According to the Ministry of Economic Affairs, wholesale trade has started to turn negative on a yearly basis since June, and was at -2.7% YoY in August compared with -1.31% in July.

Exports slowed too

Exports grew at 1.9% YoY in August after growing 4.7% in July, and there was a similar trend for imports, growing 7.9% YoY in August and 20.5% in July.

All these show that an economy that is already skewed towards the manufacturing sector could grow even slower under the China-US trade war if there is damage done to the supply chain in the electronics sector, which we believe is likely.

31.00 USDTWD by end-2018
Spot on 27 September 2018 was 30.69

USDTWD only to depreciate gradually

We realise that the USDTWD is less volatile than other currencies. One of the reasons could be that the market does not expect any change in central bank policy rate, and therefore the interest rate would be stable in Taiwan.

However, as a US rate hike in December is in the cards, and further rate hikes in 2019, we expect the New Taiwan Dollar to depreciate against the dollar gradually from 30.6 (spot on 27 September 2018) to 31.0 by the end of 2018, and further to 32.0 by the end of 2019.

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